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# AUDIT REPORT



NEIGHBORHOOD COMMONS COOPERATIVE

AUDIT OF PROJECT OPERATIONS

CHICAGO, ILLINOIS

00-CH-212-1004

AUGUST 8, 2000

OFFICE OF AUDIT, MIDWEST  
CHICAGO, ILLINOIS

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Issue Date	August 8, 2000
Audit Case Number	00-CH-212-1004

TO: Edward J. Hinsberger, Director, Chicago Multifamily Hub

FROM: Dale L. Chouteau, District Inspector General for Audit, Midwest

SUBJECT: Neighborhood Commons Cooperative  
Multifamily Rental Housing  
Audit of Project Operations  
Chicago, Illinois

We completed an audit of the project operations at Neighborhood Commons Cooperative. The audit was conducted in response to a request from the Chicago Multifamily Hub to assess HUD's concerns about: (1) management and operational problems at the complex, and (2) a change in management agents. The objective of the audit was to determine whether project funds were used in compliance with the Regulatory and other agreements, and applicable HUD policies and procedures.

We found that the former management agent failed to adequately collect monthly rent payments because it did not take corrective actions in a timely manner to uniformly apply the HUD-approved rent schedule, and did not maintain accurate books and records. We also found that the former Board abused its authority and undermined the management agent by taking control of the Cooperative's daily operations. In addition, the Board ignored HUD directives and took various actions that benefited some Board members, their relatives and friends.

Within 60 days, please provide us, for each recommendation made in this report, a status report on: (1) the corrective action taken; (2) the proposed corrective action and the date to be completed; or (3) why action is considered unnecessary. Also, please provide us copies of any correspondence or directives issued because of the audit.

Should you or your staff have any questions, please contact me at (312) 353-7832.

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We completed an audit of Neighborhood Commons Cooperative, a HUD-insured multifamily property in Chicago, Illinois. The audit resulted from a request by the Director, Multifamily Hub, in the Illinois State Office. HUD performed a Management Review of the Cooperative in January 1999 that resulted in a number of concerns, including excessive tenants accounts receivable and inadequate collection efforts by the management agent; ineligible expenses charged to the project; actions by the former Board of Directors that exceeded its authority; and the granting of rent-free units without HUD approval. Our audit objective was to determine whether project funds were used in compliance with the Regulatory and other agreements, and applicable HUD policies and procedures.

We found that the former management agent failed to adequately collect monthly rent payments because it did not take corrective actions in a timely manner to uniformly apply the HUD-approved rent schedule, and did not maintain accurate books and records. As a result, the Cooperative's ability to make its mortgage payments may have been impacted, and there is an increased risk that a claim may be paid from HUD's insurance fund.

We also found that the former Board abused its authority and undermined the management agent by taking control of the Cooperative's daily operations. In addition, the Board ignored HUD directives and took various actions that benefited some Board members, their relatives and friends. The result was that program requirements were not met, applicable regulations were not followed and project resources may have been used for ineligible or inappropriate purposes. The Board also exercised excessive control over the new member selection process by not selecting applicants from the waiting list in sequential order. Consequently, the Board may have discriminated against citizens of the surrounding community in violation of equal housing opportunity laws.

#### Excessive Tenant Accounts Receivable Balance

Unpaid rents of current tenants living in the 168-unit Cooperative exceeded \$270,000 as of May 1999. The unpaid balance would have been significantly higher if the Cooperative had not received excess subsidies from the Chicago Housing Authority. The former property management agent did not adequately collect monthly rent payments because it did not adhere to the HUD-approved rent schedule. The agent claimed that delinquencies were high because records of unpaid balances received from the previous management agent were confusing, and that subsidy payments from the Chicago Housing Authority were not received for a nine-month period.

#### The Board of Directors Abused Its Authority

The former Board of Directors abused its authority and mismanaged the Cooperative by undermining the management agent and taking control of the daily operations of the property. The former Board President hired a close personal associate to

serve as on-site manager, who took instructions from the Board President rather than the management agent. In addition, the on-site manager was provided with a rent-free unit, an action that HUD did not approve and, therefore, violated the Regulatory Agreement.

The former Board President, a Section 8 rent assistance recipient, was hired by the management agent and paid from non-project funds for a three-month period to reconcile the tenant accounts receivable. We also determined that she was employed at a temporary employment service, but that she failed to report her income from both sources to HUD. As a result, she received excess rent subsidies to which she was not entitled.

The Cooperative Failed to Provide Equal Housing Opportunity

The Cooperative failed to provide an equal opportunity to housing when it filled vacant units with relatives and friends of preferred Cooperative members. An agreement between the Cooperative and the Leadership Council for Metropolitan Open Communities required the Cooperative to offer vacant units to displaced residents of the Cabrini Green housing project, a neighboring public housing site that was slated for demolition. Cabrini residents were to be selected on an alternating basis with other applicants whose names were placed on a waiting list. The Cooperative Board did not take sufficient action to fulfill this commitment.

A lengthy waiting list that existed prior to formation of the Cooperative in November 1996 was not used properly to select new members for available units. When selections from the list were made, they were done so on a non-sequential basis. The former Board President controlled the member selection process despite the formation of a Member Selection Committee. The management agent was not informed in advance of several tenant move-ins, and could not, therefore, evaluate the selection criteria used for compliance with the selection policy.

Recommendations

We recommend that the Director, Chicago Multifamily Hub, ensures that the new management agent collects all outstanding rent payments, initiates reasonable payment plans, or evicts tenants as appropriate; ensures that all Section 8 subsidies received by the Cooperative are based on the correct rent

schedule; assesses the former management agent's maintenance of tenant records when conducting management reviews of other projects managed by the agent; initiates proceedings to debar the former Board President from participation in all Federal programs; initiates proceedings to debar the former Board President's personal associate from participation in all Federal programs; provides technical assistance to the current Board stressing how much authority it has and the rules it must adhere to while the Cooperative's mortgage is insured by HUD; performs a follow-up management review at the Cooperative to ensure that adequate policies and procedures are being followed; sanctions members of the current Board if they interfere with the daily operations of the property and violate applicable agreements; declares a technical default of the Regulatory Agreement and initiates foreclosure proceedings if such interference does occur; refers the issue concerning equal housing opportunity to the Office of Fair Housing and Equal Opportunity to determine whether any laws were violated; ensures that the current management agent assumes control over the tenant selection process; ensures that terms of the Leadership Council agreement are adhered to; ensures that the Cooperative makes a reasonable effort to determine whether persons on the waiting list are still interested in units; and ensures that control measures are implemented to prevent the Board from circumventing the waiting list.

We presented our draft findings to the Board of the Cooperative during the course of the audit. We held an exit conference with the Board on July 3, 2000. The Board, former management agent, and former Board President provided comments to our draft findings, which are included in their entirety as Appendices to this report. Excerpts of the comments are included with each finding. Where appropriate, changes were made to the draft findings to reflect additional information or clarification resulting from the exit conference and auditee comments.

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# Introduction

Neighborhood Commons Cooperative is a 168-unit apartment complex that was originally constructed in 1974. The Cooperative was legally formed by the tenants in October 1996 following foreclosure by HUD against the previous owners. HUD sold the property to the Cooperative for one dollar and provided a grant and a HUD-insured mortgage under Section 221 (d) (4) of the National Housing Act to finance rehabilitation of the units. At the time of the sale, many of the tenants were receiving project-based Section 8 subsidies whereby HUD paid the subsidy directly to the property management company. When the Cooperative was formed, however, HUD converted the Section 8 subsidy to a tenant-based voucher administered by the Chicago Housing Authority. The property is designated in HUD records as Project Number 071-35634, and is located at 1600 North Vine Street, Chicago, Illinois.

Since inception of the Cooperative, HUD periodically monitored activities at the complex by performing management reviews. In the course of the reviews, HUD identified various deficiencies that impacted both the fiscal and operational management of the property. The review completed by HUD in January 1999 resulted in an overall rating of “Unsatisfactory”, primarily attributed to violations of the Regulatory Agreement, Cooperative By-laws, Management Certification, Management Agreement and Occupancy Agreements. Also cited were policies and procedures that were ineffective or lacking that resulted in frequent adverse findings and a general failure to comply with HUD’s requirements. HUD expressed particular concern about the former management agent’s inability to collect delinquent carrying charges (rent payments) from 74 tenants, three of whom were members of the Cooperative’s Board of Directors.

The findings cited above, aggravated by a growing tension between Board members and the former management agent, prompted HUD to request an OIG audit in January 1999.

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## Audit Objective

Our audit objective was to determine whether Project funds were used in compliance with the Regulatory and other agreements, and applicable HUD policies and procedures.

## Audit Scope And Methodology

The audit covered the period November 1996 to April 1999. We performed our on-site audit work between April 1999 and July 1999. We conducted the audit in accordance with generally accepted government auditing standards at the on-site management office of Neighborhood Commons Cooperative, and at the offices of the former and current management agents.

To determine the status of tenant accounts receivable balances, we reviewed all tenant rent payments by examining copies of bank deposit slips and supporting checks or money orders for the period noted above. These were compared to individual

Occupancy Agreements to ascertain whether tenants paid the correct amount of rent in accordance with the HUD-approved rent schedule. We obtained tenant accounts receivable balances from HUD and the former and current management agents to determine the correct amount of funds in arrears owed by each Cooperative member. Since the amounts obtained from each of these sources differed, we re-calculated the delinquent amounts based on manual entries made on tenant ledger cards maintained by the former management agent compared to Occupancy Agreements and subsidy data obtained from the Chicago Housing Authority. This re-calculation, conducted as of May 30, 1999, was accomplished by subtracting the total of payments made by the tenant, Chicago Housing Authority and HUD from the total rents collected by the Cooperative. This process resulted in an outstanding receivable balance of \$270,049.

To determine whether project funds were properly used, we reviewed the small amount of records that were available from the former management agent. However, as indicated later in this report, due to poor recordkeeping, we were unable to rely on the validity of that information. The remaining audit work was conducted through interviews with Board members, tenants, personnel employed by the former and current management agents, the Cooperative's legal counsel, and Chicago Housing Authority and HUD personnel.

We provided a copy of this report to the current Board President of the Cooperative.

# Excessive Tenant Accounts Receivable Balance

As of May 1999, the unpaid rents of current tenants living in the 168-unit Cooperative exceeded \$270,000, and would have been significantly higher if the Cooperative had not received excess subsidies from the Chicago Housing Authority. The former management agent failed to adequately collect monthly rent payments because it did not take corrective actions in a timely manner to uniformly apply the HUD-approved rent schedule, resolve voucher subsidy problems and maintain accurate books and records. The failure to collect rents may seriously impact the Cooperative's ability to make its mortgage payments and maintain the property in a safe and sanitary condition. In addition, there is an increased risk that a claim will be paid from HUD's insurance fund.

## Regulations Mandated By FHA Program

The Regulatory Agreement stipulates that:

“The Mortgagor shall establish and collect monthly carrying charges pursuant to the conditions set forth [in the Regulatory Agreement]”.

“Mortgagor shall not permit occupancy of its accommodations except in accordance with a schedule of charges approved by the Commissioner and such schedule shall not be changed except with the written approval of the Commissioner.”

“The books and accounts of the Mortgagor shall be kept in accordance with the uniform system of accounting prescribed by the Commissioner.”

## Background on Rental Assistance and Maintenance of Records

At the start of the audit, HUD asked us to reconcile the tenant accounts receivable balance. Due to poor record keeping by the previous management agent, the Independent Public Accountant could not verify the receivable balance during the 1997 and 1998 audits, resulting in a qualified opinion. Thus, HUD had little confidence in the records maintained by the management agent.

## Management Agent Failed To Collect Monthly Rent Payments

As of May 1999, the balance of delinquent rents owed by the current tenants to the Cooperative exceeded \$270,000, which would have been significantly higher if the Cooperative had not received excess subsidies from the Chicago Housing Authority. We verified the balance by identifying payments received from tenants and from the Chicago Housing Authority that were deposited into the project accounts. The management agent

failed to collect monthly rent payments because it did not take corrective actions in a timely manner to uniformly apply the HUD-approved rent schedule, resolve voucher subsidy problems and maintain accurate books and records. Due to the Board's substantial influence over management, we questioned whether it exacerbated the problems since many members financially benefited by not paying their full rental commitment or by receiving excessive subsidies.

The owner of Diversified Realty Group, the Cooperative's former management agent, told us that it never had a handle on the tenant accounts receivable balance primarily because they had difficulty getting beginning balances from the prior management agent, ARCO Management, and because it took nine months to get subsidy payments from the Chicago Housing Authority after HUD dropped the tenant-based subsidies. According to several members of the Board, the Board attempted to inform HUD and Diversified of the correct rents but Diversified did not adhere to the rents.

The environment at the property was unstable and confusing. During its tenure, Diversified went through a succession of five on-site managers and as many as ten different people may have worked on the manual rental payment ledger cards. Additionally, the agent had difficulty obtaining information from the Housing Authority and the tenants, and the Authority refused to make subsidy payments for units being rehabilitated because they failed to meet housing quality standards.

HUD-Approved Rent  
Schedule Not Uniformly  
Applied

Diversified did not uniformly apply the HUD-approved rent schedule. Consequently, the management agent did not always collect the correct amounts from the tenants or the Housing Authority that administered the Section 8 subsidy payments. Diversified's owner told us that there was much confusion at the time the Cooperative was formed over the correct rent schedule.

As a condition of participating in the program, HUD controls the per-unit rent that the Cooperative can charge its members. Since the Board is comprised of members of the Cooperative, it would not be prudent for the Board to set rent levels that might serve their self-interests and increase HUD's risk. HUD communicated the rent schedule in the initial closing documents

and foreclosure prospectus, as well as in subsequent letters and meetings. We were unable to determine why management did not uniformly apply the correct rents from inception of the Cooperative.

Wrong Rents Reported To  
CHA Resulted In Over-  
Subsidies

The tenant accounts receivable balance would have been significantly higher if the Housing Authority had not paid excess subsidies to the Cooperative. The Housing Authority paid excess subsidies because of the previously cited confusion over the correct rents. When HUD learned about the over-subsidies it notified the Authority to correct the problem the next time the tenants were re-certified. Since HUD permitted the continuance of the overpayments, we did not quantify the total excess subsidies. The overpayments significantly reduced many tenants' past due balance, and, as of May 1999, the Cooperative had collected over \$28,000 in payments higher than the tenants' true obligations.

It appears that most of the vouchers are now based on the correct rents. We provided the Authority with a list of members receiving subsidies along with the current rent schedule so it could be certain that the rents for all over-subsidized tenants were calculated correctly during the tenants last re-certification.

Write-Off Of Current  
Tenants' Delinquencies

In April 1998, Diversified requested that HUD approve the write-off of a large portion of the then \$242,407 tenant accounts receivable balance. HUD responded to Diversified that it could write-off back rents related only to non-payment by the Housing Authority that were due to units failing to meet housing quality standards. The management agent planned to reduce the tenant accounts receivable balance by over \$200,000, accounting for the total receivable due from the Housing Authority. Because the management agent did not differentiate in its proposed write-off plan between delinquencies attributed to violations of the standards and those resulting from other reasons, HUD withheld approval for the write-off until it could examine Diversified's proposal in more detail. Thus, the delinquencies remained outstanding.

The Board recently requested that HUD forgive the entire past due balance. We believe that HUD should only approve the write-off of delinquencies caused by the Housing Authority's

inability to inspect or pass units not in conformance with Housing Quality Standards. HUD agreed, and on March 22, 2000, it authorized the reversal of tenant accounts receivable totaling \$94,513. The write-off represented payments that the Housing Authority did not make because units were not ready for inspection.

New Management Agent  
Significantly Improved  
Rental Collections

We provided the current management agent, Professional Property Services, with a draft schedule showing our derivation of the outstanding tenant accounts receivable balances for current tenants. Based on this information the agent sent notices to tenants initiating collection procedures, significantly improving the monthly collections and resulting in the eviction of two tenants. Furthermore, for tenants with large past due amounts, the new agent is in the process of categorizing them by the circumstances that caused their delinquency. Only those amounts meeting HUD's approval will be written-off. The agent should continue collecting past due amounts or completing corrective actions for delinquencies not meeting HUD's criteria.

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The Cooperative's  
Comments

Excerpts from the Cooperative's comments on our draft finding follow. Appendix A, Pages 29 to 32, contains the complete text of the comments:

To the degree that we have knowledge, our research indicates your assumptions and comments fairly and appropriately state the facts. We agree that our new management agent has significantly improved the rental collections at Neighborhood Commons Cooperative, however, please note that their directions were approved and supported by the Board of Directors.

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OIG Evaluation of  
The Cooperative's  
Comments

The Cooperative agreed with Recommendations 1A and 1B.

## Diversified's Comments

Excerpts from Diversified Realty Group's comments on our draft finding follow. Appendix B, Pages 33 to 37, contains the complete text of the comments:

Diversified Realty Group disagrees with the statement referenced in Finding 1 that the management agent "failed to adequately collect monthly rent payments...because it did not take corrective actions in a timely manner...". As early as 2/24/97, Diversified sent a letter to the Director of Multifamily Housing at HUD advising that the Section 8 rent receivables were \$116,000 in arrears as of the date of the letter. At that time, Diversified requested clarification on the rent schedule due to the fact that the schedule received in November of 1996 (with the closing documents) listed a Rent Schedule based on the old "236" program, which cited both Basic and Market rents. Unfortunately, when Neighborhood Commons Cooperative became a cooperative in November of 1996, the cooperative no longer fell within the 236 program and only Market rents could be considered. It should also be noted that, when Diversified made its request, Diversified stressed that the review was urgent, advising that the viability of the project could come into jeopardy without subsidies.

Diversified disagrees with the portion of the finding which states, "As of May 1999, the balance of the delinquent rents...was about \$270,000." A meeting was held between Diversified and HUD on April 15, 1998. At that meeting Diversified presented HUD with a list of write-offs for unpaid Chicago Housing Authority monies in the amount of \$200,088.59, which had been on record for almost a year. HUD advised that it would follow-up and respond in writing and on April 24, 1998, HUD directed Diversified to write-off back rents which related to non-payments by Chicago Housing Authority resultant of the units failure to meet Housing Quality Standards. As of 4/15/98, more than \$200,000 remained outstanding and the Certification process was still incomplete, thus Diversified had no way of knowing that the arrears were related to anything other than "failing to meet housing quality standards" and wrote them off accordingly.



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OIG Evaluation of  
Diversified's  
Comments

HUD approved and communicated the rent schedule at the time the sale was closed. Regardless of whether the initial rent schedule was based on the Section 236 program, it contained the official rental rates that should have been used by the management agent until May 1, 1998, the effective date of the HUD-approved rent increase. Our audit determined that when Diversified ceased managing the property in May 1999, there were still many tenants who were not paying the correct rent amounts.

Diversified had a responsibility to ascertain the amount and nature of each tenant's delinquency before proceeding with the write-off. We determined that many of the tenants' rents were in arrears for reasons other than the units failing to meet housing quality standards. We disregarded Diversified's proposed write-off because less than 50 percent of the amount met HUD's criterion related to the standards.

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Former Board  
President's  
Comments

Excerpts from the former Board President's comments on our draft finding follow. Appendix C, Pages 38 to 41, contains the complete text of the comments:

This writer makes note that the IG must be very careful that it distinguishes the time frame in which activities took place. The problems outlined in the audit began under a different Cooperative President. It should also be noted that during the period of time mentioned [the writer] was not even a member of the Board of Directors. Certain mismanagement by Diversified Realty Group occurred under a different regime.

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OIG Evaluation of  
Former Board  
President's  
Comments

The draft finding contained no reference to any of the Cooperative Presidents, past or present. While it is true that the problem of rent delinquencies initially began during the term of an earlier president, the audit disclosed that delinquencies grew substantially during the period reviewed. In a letter dated April 24, 1998, addressed to the then-president of the Cooperative, HUD expressed concern about the "...high amount of tenant accounts receivable due from members (in excess of \$13,000)...". This is contrasted with the significantly

higher level of \$270,000 cited in the draft finding that existed 13 months later when the audit began in May 1999.

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## Recommendations

We recommend that the Director, Multifamily Hub:

- 1.A. Ensures that the management agent collects all outstanding payments, initiates reasonable payment plans, or evicts tenants as appropriate; and
- 1.B. Ensures that all Section 8 subsidies received by the Cooperative are based on the correct rent schedule.

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# The Board of Directors Abused Its Authority

The Neighborhood Commons Board of Directors abused its authority and mismanaged the Cooperative by undermining the management agent; taking control of the daily operations of the property; ignoring directives from HUD; and taking actions which benefited members of the Board, their relatives and friends. The Regulatory Agreement stipulates that the mortgagor shall provide for the management of the project in a manner satisfactory to the Commissioner. The Board members acted in a questionable manner by ignoring various directives communicated by HUD. Consequently, program requirements were not met, applicable regulations were not followed, and project resources may have been used for ineligible or inappropriate purposes.

Controls And Regulations  
Mandated for HUD Insured  
Properties

The Regulatory Agreement stipulates that:

“The mortgagor shall provide for the management of the project in a manner satisfactory to the Commissioner.”

“The mortgagor shall not without prior approval of the Commissioner, given in writing,

- permit the occupancy of any of the dwelling accommodations ... except at the charges fixed by the schedule of charges;
- enter into any contract or contracts for supervisory or managerial services.”

The Project Owner’s & Management Agent’s Certification further stipulates that:

“I, the Owner, agree to submit a new Management Certification to HUD before taking any of the following actions:

- Changing the expiration date of the Management Agreement;
- Renewing the Management Certification;
- Permitting a new Agent to operate the project; and
- Undertaking self-management of the project.”

Background On Fiscal  
Management Of  
Cooperative

Although many of the issues described in this finding were already identified by HUD, abuses by the former Board President, with the endorsement of the rest of the Board, were the root cause of the Cooperative’s problems and need to be resolved before present conditions can be corrected. The

Board of Directors was controlled by the former Board President for most of the period under review. Since inception of the Cooperative in November 1996, the development has failed to establish an acceptable level of fiscal management.

There was a continual struggle between the Board and the management agent over who controlled the daily operations of the Cooperative. Diversified Realty Group, the first management agent hired by the Board, entered into a contract to manage the property for two years. The Board initially wanted to hire the Board President to be the on-site manager but HUD did not approve that action. The Board then requested that Diversified hire a gentleman as the on-site manager with whom the Board President had a close personal association. Diversified briefly employed the Board President's associate, but terminated him after a background check found major discrepancies in his employment history and education credentials. Additionally, the agent had problems with the on-site manager because he was taking directions from the Board President rather than the agent's property managers.

Tension grew between the Board and Diversified over the staffing of on-site personnel. We learned through interviews that the Board intimidated the agent by threatening to terminate its contract if the agent did not capitulate to the Board's staffing preferences. The Board carried through with its threat and sent a notice of termination to Diversified on February 27, 1997. The next day, the agent's staff was locked out of the management office. The Board's primary justifications for the termination were the discharge of the Board President's associate and the hiring of personnel by the agent without the Board's approval. The Board hired another agent to manage the property, at which time the Board President's associate was temporarily rehired.

HUD has established procedures for approving and terminating management agents. The property owner is required to give HUD 30 days notice when it intends to terminate an agent. The successor agent must submit to HUD, Form 2530, Previous Participation Certification, which HUD must review and approve before the property owner can hire the new agent. The Cooperative did not follow these procedures. Thus, HUD procedures were violated when the Board contracted for

management services without asking the new agent to submit the required form for HUD approval. HUD informed the Cooperative that the Board needed to remove itself from the daily management of the property. Diversified was rehired to manage the property and it agreed to hire a new on-site manager within two weeks.

The members elected a new president who presided for about a year until the previous president was re-elected in May 1998. Thereafter, the Board resumed undermining the management agent. The Board notified HUD that all correspondence was to be sent directly to the Board President. HUD indicated, however, that all routine correspondence would continue to be sent to the agent. The owner of Diversified told us that the Board withheld material information, thus reducing the agent's ability to effectively manage the property.

#### Board Took Control Of Daily Management

The Management Agreement between the owners and the management agent expired on September 30, 1998. A modified Management Agreement created by Diversified Realty Group with input from the Board President granted authority to the Board to hire on-site supervisory personnel. This agreement was not required to be approved by HUD. The agent agreed to the arrangement to keep from losing the contract with the Cooperative. The Board President then rehired her associate to manage the property and hired another personal friend to supervise the maintenance staff. When the Board President's associate returned as on-site manager, Diversified lost control over the daily operations of the property because the manager took direction from the Board President rather than from Diversified. The Board President's associates were offered compensation and benefits significantly higher than previous supervisors, including rent free apartment units. Although the Board approved the hiring of the personnel, they were technically employees of the management agent.

Both the Regulatory Agreement and Management Agent Certification require the property owners to provide a level of management acceptable to HUD. At no time was the Board approved by HUD to manage the property even when Diversified began to lose control. Furthermore, the Board violated the Regulatory Agreement when it approved two rent-free units without HUD approval.

Board President Received Questionable Payments From Agent And Failed To Report Income

The Board President financially benefited when Diversified's owner agreed to pay her \$450 a month from non-project funds. The payments began the same month the modified Management Agreement became effective and ended three months later, several days before HUD began its management review of the Cooperative. The Board President received a total of \$1,350 from the agent. Diversified told us the payments were made to her for reconciling the tenant accounts receivable balance, but were stopped when Diversified realized that she had not accomplished the task.

The payments, equaling approximately 10 percent of the October 1998 management fee, were suspect because they were paid from the agent's funds rather than from project funds. The payments appeared to be a fee splitting arrangement.

The Board President, whose rent was almost fully subsidized under Section 8, failed to report to the Chicago Housing Authority the income she earned both from Diversified and from her current employer, Kelly Services, where she has been employed since May 1999. At the time of our audit, over 11 months of income was unreported. As a result, the Board President received excess rent subsidies to which she was not entitled.

HUD Identified Various Management Deficiencies

HUD performed a management review on January 14, 1999, to assess the extent of the project's problems. The property was rated "Unsatisfactory" because it violated the Regulatory Agreement, Cooperative By-laws, Management Certification, Management Agreement and Occupancy Agreements, and had ineffective or non-existent policies and procedures.

Deficiencies identified by HUD during its management review included:

- Project funds were used to pay the former Board President's personal telephone bills;
- Project funds were used to send several Board Members and some of their family members to a conference at the Disney Coronado Springs resort;
- Several Board members had delinquent carrying charges;
- Management was ineffective in attempting to collect delinquent rents;

- The rent collection policy was not uniformly applied -- some tenants were charged late fees while others were not;
- The Board, rather than the management agent, controlled the process of selecting tenants for new units and issuing Section 8 vouchers;
- Considerably higher rents were reported to the Chicago Housing Authority resulting in the Cooperative receiving excess subsidies;
- The Board approved non-revenue producing units without prior HUD approval; and
- Employees were hired by the Board at significantly higher compensation levels compared to other properties in the area.

### New Agent Has Made Improvements

The Board of Directors currently has new directors and a new president. The new management agent, Professional Property Services, began managing the property on May 1, 1999, and has made substantial strides in correcting the fiscal management of the Cooperative. The new agent informed us that it has taken a tough stance to keep the Board from overstepping its authority, and as a result, the Board threatened to terminate the agent's contract on several occasions. The Board cannot terminate the agent's contract. HUD will only initiate termination procedures for just cause.

### The Cooperative's Comments

Excerpts from the Cooperative's comments on our draft finding follow. Appendix A, Pages 29 to 32, contains the complete text of the comments:

To our knowledge, we believe some of your assumptions and comments are fair and appropriately state the facts with the following comments: (1) the Cooperative has a new President and new officers; (2) the person discussed in your findings no longer holds a position of authority; (3) the plan under the new Board and Management is to continue our efforts to establish more than an acceptable level of fiscal management; and (4) our legal counsel was not aware nor did he participate in any way in the creation of a management agreement between Diversified and Neighborhood Commons Cooperative.

We recommend there be clarification on the Cooperative Housing trip that was taken to Florida. Other Board Members



from other cooperatives attend educational conferences such as this.

We ask that your report be more specific in describing board positions as they relate to your report. There is currently a new Cooperative President and there is also one other ex-President. The By-laws identify this position as the Cooperative President. There is no position known as “Board President”.

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OIG Evaluation of  
The Cooperative’s  
Comments

The draft finding was modified to remove the reference to the Cooperative’s attorney, and to indicate that some, but not all, of the Board members or their families attended the Florida conference.

The terms “Cooperative President” and “Board President” are used interchangeably by HUD. We elected to use “Board President” in a conventional sense to identify the person having executive authority over the Board of Directors.

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Diversified’s  
Comments

Excerpts from Diversified’s comments on our draft finding follow. Appendix B, Pages 33 to 37, contains the full text of the comments, except for exhibits that were omitted due to space considerations:

Because Diversified realized that the ultimate responsibility for reconciling the books and records would fall within their purview, Diversified made the decision to absorb the cost of resolving the books. Because [the former Board President] had a good working relationship with Chicago Housing Authority, Diversified contracted [the former Board President] on a temporary basis for the exclusive task of reconciling the tenant receivables. Once it became apparent (three months later) that [the former Board President] could not accomplish this goal, the project was terminated. Diversified hired an independent contractor whom it believed possessed the requisite skill to assist with its endeavors [to] reconcile the accounts and collect rents. She was ineffective and Diversified terminated her services. Nothing more, nothing less.

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OIG Evaluation of  
Diversified's  
Comments

Prior to hiring the former Board President to perform the reconciliation task, Diversified was aware that a conflict of interest existed. The president served as a paid consultant to the project before the sale transaction, then resigned her position to apply for the on-site manager position. At the time, HUD indicated it would not permit her to serve in that capacity as a conflict of interest would be created. In view of the substantial increase in tenant receivables during this Board President's tenure, as discussed in Finding 1, Diversified, having been made aware of HUD's concern about the potential conflict, should not have engaged her for the reconciliation task.

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Former Board  
President's  
Comments

This writer suggests that [the debarment] action is not necessary because the previous President is no longer President, the ex-manager is no longer manager, and a new management agent is in place. Further, no Federal laws relating to the operation of the property were violated.

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OIG Evaluation of  
Former Board  
President's  
Comments

In assessing the conditions of the Cooperative during the tenure of the former Board President, we concluded that her actions caused the problems cited in this report to worsen. HUD indicated to us that in performing many management functions, she acted against the Regulatory Agreement requirement that the property owner provide management acceptable to HUD. The former Board President was never approved by HUD to manage the property. In addition, her failure to report the sources and amounts of outside income constituted a false certification for purposes of receiving rent subsidies.

Recommendations

We recommend that the Director, Multifamily Hub:

- 2.A. Initiates proceedings to debar the former Board President from all Federal programs;
- 2.B. Initiates proceedings to debar the former Board President's associate from all Federal programs;
- 2.C. Provides technical assistance to the Board stressing how much authority it has and the rules it must adhere to while the Cooperative's mortgage is insured by HUD;
- 2.D. Performs management reviews of other HUD-insured properties managed by Diversified to ensure they have a reliable level of management;
- 2.E. Performs a follow-up management review at the Cooperative to ensure that adequate policies and procedures have been implemented and are being followed;
- 2.F. Sanctions members of the current Board if they interfere in the daily operations of the property and violate applicable agreements; and
- 2.G. If sanctioning the Board members is ineffective, declares a technical default of the Regulatory Agreement and initiates foreclosure procedures.

# The Cooperative Failed to Provide Equal Opportunity in Housing

Management failed to provide an equal opportunity to housing at the Cooperative when it filled vacant units with relatives and friends of preferred Cooperative members. The Regulatory Agreement requires full compliance with HUD rules regarding nondiscrimination and equal opportunity in housing. The Cooperative Board exercised excessive control over the new member selection process to benefit a limited number of members. Additionally, Section 8 vouchers intended for members already residing at the Cooperative instead were improperly awarded to family members of Cooperative tenants. Consequently, the Board discriminated against citizens of the surrounding community when providing housing, and against other Cooperative members when providing subsidies.

## Regulations Mandated By FHA Program

The Regulatory Agreement stipulates that :

“The Mortgagor agrees to adhere to the priorities and preferences for membership and occupancy by families displaced from an urban renewal area or as a result of governmental action...”; and, “Mortgagor agrees that there shall be full compliance with the provisions of (1) any laws prohibiting discrimination in housing on the basis of race, color, creed, or national origin, and (2) with the Regulations of the Federal Housing Administration providing for nondiscrimination and equal opportunity in housing.”

Some of the regulations pertaining to the Federal Housing Administration program are communicated in HUD’s Handbook 4350.3 CHG-27. One of the requirements is that management create and properly maintain a waiting list of potential occupants.

## The Gautreaux Agreement

As a condition of selling the foreclosed property to the Cooperative, HUD inserted a rider in the Sales Contract which required the Cooperative to execute an agreement with the Leadership Council for Metropolitan Open Communities in order to implement the Gautreaux decree. This decree gives federal preference, as stipulated in the Regulatory Agreement, to residents of Cabrini Green Apartments, a Chicago public housing site, because its residents are in the process of being displaced by a government action to demolish Cabrini Green and other public housing sites.

The Cooperative executed a Memorandum of Understanding with the Leadership Council on October 28, 1996, in which the Board agreed to alternately fill vacancies with Cabrini Green residents as units became available until 20 displaced residents were housed. The Cooperative is an ideal location for Cabrini Green residents because it is located several blocks away from the public housing site.

The Board did not take sufficient action to fulfill this commitment. At the time of our audit, 25 vacant units had been filled but not one displaced Cabrini Green resident was given an opportunity to live at the Cooperative.

Waiting List Not Used to Fill Vacancies

When the Cooperative was formed in November 1996, there was a pre-existing waiting list containing 469 names. We determined that this waiting list was not used properly when vacant units were filled. At the time of our review, management had filled 25 units with members' children or with people personally approved by the Board President. Half of the new tenants' names were on the pre-existing list, however, most of them were lower on the list and had hundreds of names ahead of them. We discovered that the on-site management office had a second shorter list, titled Internal Transfer List, with 21 of the 25 new tenants on it. The short list, however, appeared to have been created sometime after the pre-existing list. We regard the second internal waiting list as a conflict of interest and not in compliance with the intent of HUD Handbook 4350.3 because occupancy was offered preferentially to related parties rather than to persons on the pre-existing waiting list.

HUD and the Cooperative's management received complaints from people who wanted an opportunity to move into the project. As one example, an individual complained that she first requested to be put on the waiting list in 1991. She repeatedly called the management office and was told that her name was still on the waiting list, but in 1994 she was told that her application was lost, and she was instructed to fill out another one. Subsequently, she was told that the waiting list, and her new application, were again lost. We confirmed that the person's name was on the pre-existing waiting list. However, six people lower on the list, and 12 others who were not on the list, obtained housing at the Cooperative before this individual who had been waiting for seven years. Professional Property

## HUD Directives Ignored

Services, the current management agent, is now using the original pre-existing waiting list at HUD's request.

In January 1997, HUD became concerned about potential charges of housing discrimination. To avoid possible conflicts of interest, HUD strongly recommended that the Cooperative either create a membership committee or delegate the responsibility to the management agent. The Board chose to form a member selection committee.

Initially, some members wanted to be transferred into larger units because of their family size. HUD agreed that if a family size qualified for a larger unit, it could be moved if such a unit was available. The Board stated in an April 1998 correspondence to HUD that it would accommodate move-ins of all current members in need of transfer, and so-called "split member families" before it would accommodate all others. Split families are households with teenagers or young adults who wish to live in two separate units. HUD disapproved of giving a family two separate units and told the Board that the same requirements that apply to any other prospective member also apply to "split" families. HUD reiterated that vacancies should be alternately filled by Cabrini Green tenants and people from the regular waiting list.

The Cooperative's attorney recommended in May 1998 that management draft membership selection standards, policies and procedures for HUD's review. Policies and procedures were drafted by the Board. According to a key provision of the Member Selection Policy, first priority was to be given to current residents of the Cooperative in good standing. The Board's actions indicated that it used this provision to justify ignoring normal waiting list requirements when providing housing to "split" family members. HUD informed us that it received a draft copy of the Member Selection Policy, but did not formally approve the policy. We found no evidence that the Cooperative implemented the policy.

The Board ignored HUD's directives. Twenty of the 25 new move-ins were children of current members or "split" families. A former Board member told us that some of the 25 new occupants were not even living on the property. In order to

Board President Controlled  
Member Selection Process

justify getting a new unit, children temporarily moved back in with their parents to claim “split” family status.

Although a Member Selection Committee was established, the Board President prevented the committee from functioning in its full capacity. The former chairman of the selection committee told us that the Board President withheld the waiting list from the committee and the number of units that were available. The former chairman also claimed that the Board President threatened to dismiss committee members if they disagreed with her decisions and instructed the committee not to make units available to Cabrini Green residents because there were not enough apartments for them.

The Board President by-passed the tenant selection process by granting subsidized housing to her personal associates. Although the selection committee was supposed to interview all of the prospective tenants, it did not learn about some move-ins until after the Board President allowed new tenants to move in. In addition, three vacant units were provided to associates of the Board President who were hired to work on-site (as discussed in Finding 2), two of whom were provided rent-free units.

Diversified’s control over move-in activities was weak. It did not get involved with the member selection process until after some move-ins occurred, at which time it would process the applicants’ paperwork. Diversified had a responsibility to ensure that tenant selection policies and procedures were established and adhered to by the on-site manager. When the agent learned that people were moving into the property, it had a duty to determine how the members were selected, evaluate the selection criteria used by the Board, and report abuses to HUD in a timely manner.

Vouchers Issued To  
Tenants’ Children

As part of the HUD agreement to sell the property to the Cooperative, and in order to facilitate the change from a project-based subsidy to a tenant-based subsidy, HUD set aside 112 Section 8 vouchers for Cooperative members. These vouchers were intended for members who were previously subsidized or who would have a hardship paying the market rates set by HUD. Thirteen Section 8 vouchers were provided by the Chicago Housing Authority to members’ children before existing members had an opportunity to use

them. The members' children were not previously receiving subsidies and were living either with their parents or off-site. The children were not members of the Cooperative at the time of the sale and were not the intended recipients of the rental assistance set aside by HUD. Issuing vouchers to members' children was a conflict of interest and may have denied rental assistance to other members who needed it.

The Board has requested 30 additional vouchers for eligible tenants needing assistance but who failed to get vouchers for whatever reason. Unfortunately, all of the vouchers have been issued, according to HUD. Remaining members who qualify for assistance will have to go through the same process as every other family in Chicago seeking vouchers.

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### The Cooperative's Comments

Excerpts from the Cooperative's comments on our draft finding follow. Appendix A, Pages 29 to 32, contains the full text of the comments.

We find it necessary to deny that any of the conduct described in this finding, in any way, constitutes a violation of the Fair Housing Laws of either the United States, State of Illinois or City of Chicago. In addition, we advise you that our current management agent informed the Board that: (a) they had a difficult time locating the appropriate people to contact now that Gautreaux no longer exists; (b) the contacts they have been working with have now been able to produce two recent Cabrini Green applicants in all the time it has been working with the Cooperative; (c) this Board intends to honor and implement the Leadership Council Memorandum of Agreement, which was entered at the time of the Cooperative's taking title to the property.

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### OIG Evaluation of The Cooperative's Comments

The practice of allocating scarce Federally funded resources to family members or other related parties is not in keeping with the spirit of Fair Housing and Equal Opportunity laws. The clear intent of those laws is to promote and protect the right of equal housing opportunity against discriminatory practices. Selecting applicants from a waiting list in non-sequential order, maintaining a second waiting list separate from the main list, and offering available units to related parties on a preferential basis,



may be construed as discriminatory practices. Recommendation 3A below, if implemented, will determine whether such practices existed.

With respect to the Cooperative's statement that the Gautreaux Decree no longer exists, HUD's Office of Assistant General Counsel advised OIG that legal proceedings giving rise to the decree in the case of *Gautreaux v. Landrieu* have not been fully settled. However, the Cooperative entered into a Memorandum of Understanding with the Leadership Council for Metropolitan Open Communities on October 28, 1996. This agreement obligated the Cooperative to provide housing for 20 residents displaced from the Cabrini Green public housing site on an alternating basis with other persons on the Cooperative's waiting list. The terms of the Memorandum of Understanding exist independently of the Gautreaux Decree and remain in force, according to HUD.

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Diversified's  
Comments

Excerpts from Diversified's comments to our draft finding follow. Appendix B, Pages 33 to 37, contain the full text of the comments.

The substantial number of move-ins (approximately 25), which were afforded to friends and family members of [the former Board President], occurred between November and December of 1998. By the very nature of the job description and responsibilities of an on-site manager, one has great latitude in controlling the day to day activities of the property. In this instance, the on-site manager moved these individuals into the apartments and neither forwarded the corresponding paperwork concerning the move-ins nor reported the move-ins to the Property Supervisor. Thus, Diversified did not become aware of the on-site manager's practices regarding move-ins for two months. Unfortunately, this practice is far too common in the "rental world". Once Diversified became apprised of the situation, they responded.

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OIG Evaluation of  
Diversified's  
Comments

As the employer of the on-site manager, Diversified had a duty to closely monitor the manager's actions to ensure that established policies and procedures were followed. Diversified assured HUD that constant supervisory oversight was being provided at the property that should have detected the absent paperwork before a two-month period elapsed.

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The Former Board  
President's  
Comments

The record and evidence will show that all current members already residing at the Cooperative had the opportunity to be certified to receive vouchers. Because there were vouchers allocated to the Cooperative that had not been used even after all current, eligible households had been served, the Chicago Housing Authority allowed the distribution of the remaining vouchers to adult members of households that had already received vouchers. No rental assistance was "denied" existing members who were eligible to receive it.

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OIG Evaluation of  
Former Board  
President's  
Comments

From interviews we conducted with tenants, we concluded that some members were under the mistaken belief that they only had to pay a portion of their rent and the Cooperative would take care of the balance. Due to poor communication by the management agent, members who could not afford to pay market rates were not informed that they needed vouchers to meet their rent obligations.

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Recommendations

We recommend that the Director, Multifamily Hub:

- 3A. Refers this matter to the Office of Fair Housing and Equal Opportunity to determine whether any laws were violated and, if so, ensures that appropriate actions are taken;
- 3B. Ensures that the new management agent assumes control of the tenant selection process from the Board;
- 3C. Ensures that residents of Cabrini Green are provided housing opportunities at the Cooperative consistent with the intent of the Gautreaux Agreement;

- 3D. Ensures that the Cooperative makes a reasonable effort to determine whether persons on the prior waiting list are still interested in units;
- 3E. Ensures that control measures are implemented to prevent the Board from circumventing the waiting list.

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# Management Controls

In planning and performing our audit, we considered the management controls of Neighborhood Commons Cooperative and Diversified Realty Group in order to determine our auditing procedures, not to provide assurance on the controls. Management controls include the plan of the organization, methods and procedures adopted by management to ensure that its goals are met. Management controls include the processes for planning, organizing, directing and controlling program operations. They include the systems for measuring, reporting and monitoring program performance.

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## Relevant Management Controls

We determined the following management controls were relevant to our audit objectives:

- Program Operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Validity and Reliability of Data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.
- Safeguarding Resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss and misuse.

We assessed all of the relevant controls identified above.

It is a significant weakness if management controls do not provide reasonable assurance that the process for planning, organizing, directing and controlling program operations will meet an organization's objectives.

## Significant Weaknesses

Based on our review, we believe the following items are significant weaknesses:

- Program Operations

The Cooperative's and management agent's controls did not ensure that the property operated according to program requirements. HUD found that management did not: adhere to the HUD-approved budget; attempt to obtain goods and services at competitive prices; submit monthly reports; ensure

that funds were used for eligible expenses only; collect monthly rents; obtain authorization for non-revenue producing units; apply eviction and fee procedures in a consistent manner; prevent the owners from overstepping their authority; have a written tenant selection policy; fill 21 units in accordance with waiting list procedures; and adhere to its agreement with the Leadership Council to alternately fill 20 units with displaced Cabrini Green residents. Due to the weak control environment, numerous control weaknesses identified by HUD, and the transition of management agents, we did not rely on any controls relating to program operations when planning our survey and audit work.

- Validity and Reliability of Data

The Cooperative's and management agent's controls did not ensure that rental receipt information was accurate. We noted differences in rent data between the manual payment history cards and the computerized rent ledgers because management did not perform routine reconciliations of the records. Due to the weak control environment, numerous control weaknesses identified by HUD, and the fact that the Independent Public Accountant issued two qualified opinions because of the tenant accounts receivable problem discussed in Finding 1, we did not rely on any controls relating to the validity and reliability of data when planning our survey and audit work.

- Safeguarding Resources

The Cooperative's and management agent's controls did not ensure that only eligible expenses were paid with project funds. The management agent approved questionable payments to pay personal expenses of some Board members. Bank deposits were not routinely made every day, and when receipts were left in the office overnight, they were not secured in a locked container. Due to the weak control environment cited above, we did not rely on any controls related to the safeguarding of resources when planning our survey and audit work.

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# Follow Up On Prior Audits

This is the first audit of Neighborhood Commons Cooperative by HUD's Office of Inspector General.



May 30, 2000

Mr. Ronald F. Huritz  
Assistant District Inspector General for Audit  
Department of Housing and Urban Development  
77 West Jackson Boulevard  
Suite 2646  
Chicago, Illinois 60604-3507

Re: Response to Audit Findings  
Neighborhood Commons Cooperative

Dear Mr. Huritz:

This letter acknowledges receipt of the audit findings for Neighborhood Commons. The Board of Directors has met and discussed these findings and our responses are attached.

Please note that the current Board of Neighborhood Commons has three new members who, along with the pre-existing Board Members, have positively impacted the overall performance of the Board of Directors.

We make use of our legal counsel for advice and counsel. We have new and capable management which has been helpful to us in facing many of the existing problems the newly constituted Board faced. Our Board has grown and is learning more about its roles, responsibilities and limits and we intend to make further improvements in our performance.

Please feel free to contact me if I can answer any questions. We look forward to the audit meeting.

Sincerely,

Shirley Hardiman  
President  
Neighborhood Commons Cooperative



RESPONSES TO AUDIT REPORT  
INSPECTOR GENERAL REPORT  
MAY, 2000

Finding 1. Tenant Accounts Receivable Balance

To the degree that we have knowledge, our research indicates your assumptions and comments fairly and appropriately state the facts. We agree that our new management agent has significantly improved the rental collections at NCC, however, please note that their directions were approved and supported by the Board of Directors. With respect to Section 3 and 4, we refer you to Ms. Avraham's response.

Recommendations:

- 1.A We agree.
- 1.B We agree.
- 1.C This finding has no relationship to NCC's current situation. We have no comment.

Finding 2. Abuse of Board of Director's Authority

To our knowledge, we believe some of your assumptions and comments are fair and appropriately state the facts with the following comments: (1) the Cooperative has a new President and new officers; (2) the person discussed in your findings no longer holds a position of authority; (3) the plan under the new Board and Management is to continue our efforts to establish more than an acceptable level of fiscal management; and (4) our legal counsel was not aware nor did he participate in any way in the creation of a management agreement between Diversified and NCC.

We recognize that in order for our current Management Agent to fulfill their responsibilities as Management Agent, it was necessary for them to take a strong position on some issues. This may have caused some misunderstandings between the Board and Management. We also acknowledge and understand that in order to cancel the Management Agreement for "cause", the reasons should be clearly stated and a new agent be HUD approved.

We recommend there be clarification on the Cooperative Housing trip that was taken to Florida. Other Board Members from other cooperatives attend educational conferences such as this. However, we specially call your attention to these facts: (a) Mr. Gideon Adjetey and Ms. Denise Threatt did not attend that conference. Ms. Jean Mays did attend, however, she paid her own air fare. We refer you to Ms. Avraham's response.

Recommendations:

- 2.A All findings and required responses to issues regarding Jesse Avraham must be responded to by Ms. Avraham. We have no comment.
- 2.B We have no response or comments regarding Ms. Avraham and/or Warren Jones.

We ask that your report be more specific in describing board positions as they relate to your report. There is currently a new Cooperative President and there is also one other ex-President besides Ms. Avraham. The By-Laws identify this position as the Cooperative President. There is no position known as "Board President".

- 2.C We accept whatever technical assistance provided.
- 2.D Not applicable. We have no comment.
- 2.E This is acceptable to the Board and Management.
- 2.F The Board takes your comments under advisement and understands the recommendation. However, it is the Board's position that recommending such action is not necessary. This Board will work to see that this not be a scenario for NCC. There also needs to be an understanding on HUD's part that the Board has a right to re-direct Management when Management may become inconsistent with legitimate Board established policy.
- 2.G The Board does not expect such sanctions to be necessary.

### Finding 3 Failing to Provide Equal Opportunity in Housing

We respond to this Finding with the advice of our legal counsel. We find it necessary to deny that any of the conduct described in this Finding, in any way, constitutes a violation of the Fair Housing Laws of either the United States, State of Illinois or City of Chicago. In addition, we advise you that our current management informed the Board that: (a) they had a difficult time locating the appropriate people to contact now that Gautreaux no longer exists: (b) the contacts they have been working with have now been able to produce two recent Cabrini Green applicants in all the time it has been working with the Cooperative; (c) this Board intends to honor and implement the Leadership Council Memorandum of Agreement, which was entered at the time the Cooperative's taking title to the property. These two applicants' processing is being assisted in every way and we anticipate approval and occupancy to take place shortly.

We accept the facts presented regarding the Regulations mandated by FHA Programs and the Gautreaux Agreement.

Considering the limited knowledge the current Board has, with respect to past management practices, we are unable to dispute or confirm the facts outlined in your report regarding the previous use of the waiting list and the ignoring of HUD's directives to the previous Board and Committee.

The current Board does not dispute your description of the actions of the previous President or Committee. Due to a lack of knowledge we (a) have no comment and (b) suggest that responses regarding the past president be responded to by the past president.

Recommendations:

3.A We disagree with this recommendation for reasons outlined above.

3.B The Management Agent is now in control of the official waiting list.

3.C Gautreaux no longer exists. However, due to our new management agent's efforts an appropriate contact has been made and a working relationship established with two applicants moving through our selection system.

3.D This is currently part of our selection process. Our list is maintained in chronological order and applicants are notified from that list, except for Cabrini Green applicants who go to the top of the list in this manner: (1) the next three available units to catch up for the time we were not able to institute this program and (2) then every other new applicant will be from the Cabrini Green list.

3.E It is the goal of our current Board to ensure that the waiting list is appropriately managed by management, in accordance with the selection criteria established by the Board of Directors.

May 31, 2000

Ronald F. Huritz  
Assistant District Inspector General for Audit  
U.S. Department of Housing and Urban Development  
Office of Inspector General for Audit, Midwest  
Ralph H. Metcalfe Federal Building  
77 West Jackson Boulevard, Suite 2646  
Chicago, IL 60604-3507  
*SENT VIA HAND DELIVERY*

RE: Inspector General Audit "Draft" of May 5, 2000

Dear Mr. Huritz:

Following this page, please find *Diversified Realty Group, LLC's* Responses to the three draft audit findings made by the HUD Office of Inspector General.

It is our understanding that DRG's comments will be included verbatim in the final report.

It is further our understanding the draft findings are subject to revision.

We look forward to the conclusion of this matter.

Very truly yours,  
BOBBY L. WARE AND ASSOCIATES, LLC

Bobby L. Ware  
Attorney-at-Law

BW:ce  
cc: Debra Hunter  
enclosures (*omitted for brevity*)



project opened and 14 months subsequent to DRG's initial request, that DRG and CHAC were provided with information from HUD about the official rent rates.

ISSUE B: DRG disagrees with the portion of finding #2 which states, "As of May 1999, the balance of the delinquent rents...was about \$270,000."

DRG RESPONSE: A meeting was held between DRG and HUD on April 15, 1998. At that meeting DRG presented HUD with a list of write-offs for unpaid CHAC monies in the amount of \$200,088.59, which had been on record for almost a year. HUD advised that it would follow-up and respond in writing and on April 24, 1998, HUD (in the monthly Accounting Report) directed DRG to write-off back rents which related to non-payments by CHAC resultant of the units failure to meet Housing Quality Standards. As of 4/15/98, more than \$200,000 remained outstanding and the Certification process was still incomplete, thus DRG had no way of knowing that the arrears were related to anything other than "failing to meet housing quality standards" and wrote them off accordingly.

CONCLUSION: The requested clarification on the Rent Schedule would have tremendously assisted the remedial process of reconciling the accounts.

RECOMMENDATIONS: 1.A. DRG has no objection to the IG's recommendation.  
1.B. DRG has no objection to the IG's recommendation.  
1.C. DRG has no objection to the IG's recommendation.

#### IG FINDING #2:

"The Neighborhood Commons Board of Directors abused its authority and mismanaged the Cooperative by undermining the management agent; taking control of the daily operations of the property; ignoring directives from HUD; and taking actions which benefited members of the Board, their relatives and friends. The Regulatory Agreement stipulates that the mortgagor shall provide for the management of the project in a manner satisfactory to the Commissioner. In our opinion, the Board members lacked integrity and conducted themselves as though they were above the rules and regulations communicated to HUD. Consequently, program requirements were not met, applicable regulations were not followed, and project resources were used for ineligible or inappropriate purposes."

ISSUE: Whether fees were improperly paid to Board President by the Managing Agency.

**DRG RESPONSE:** Because DRG realized that the ultimate responsibility for reconciling the books and records would fall within their purview, notwithstanding extenuating circumstances, DRG made the decision to absorb the cost of resolving the books. Because Ms. Avraham had a good working relationship with CHAC, DRG contracted Ms. Avraham on a temporary basis for the exclusive task of reconciling the tenant receivables with CHAC. She was paid Ten Dollars per hour (\$10.00) for Ten hours a week for a total monthly payment of approximately \$450.00. Once it became apparent 3 months later that Ms. Avraham could not accomplish this goal, the project was terminated. DRG then hired Account temps in an effort to complete the task.

**CONCLUSION:** Diversified hired an independent contractor, whom it believed, possessed the requisite skill to assist with its endeavors [to] reconcile the accounts and collect rents, she was ineffective, DRG terminated her services. Nothing more, nothing less.

**RECOMMENDATIONS:**

- 2.A. DRG has no objection to the IG's recommendation.
- 2.B. DRG has no objection to the IG's recommendation.
- 2.C. DRG has no objection to the IG's recommendation.
- 2.D. DRG has no objection to the IG's recommendation.
- 2.E. DRG has no objection to the IG's recommendation.
- 2.F. DRG has no objection to the IG's recommendation.
- 2.G. DRG has no objection to the IG's recommendation.

**IG FINDING #3:**

“Management failed to provide an equal opportunity to housing at the Cooperative when it filled vacant units with relatives and friends of preferred Cooperative members. The Regulatory Agreement requires full compliance with HUD rules regarding nondiscrimination and equal opportunity in housing. The Cooperative Board exercised excessive control over the new member selection process to benefit a limited number of members. Additionally, Section 8 vouchers intended for members already residing at the Cooperative instead were improperly awarded to family members of Cooperative tenants. Consequently, the Board discriminated against citizens of the surrounding community when providing housing, and against other Cooperative members when providing subsidies.”

**ISSUE:** Whether the Managing Agent was “negligent when it failed to ensure the adequate tenant selection policies and procedures were established...”

**DRG RESPONSE:** The substantial number of move-ins [approximately Twenty-Five (25)], which were afforded to friends and family members of Ms. Avraham, occurred between November and December of 1998. By the very

nature of the job description and responsibilities of an on-site manager, one has great latitude in controlling the day to day activities of the property. In this instance, the on-site manager moved these individuals into the apartments and neither forwarded the corresponding paperwork concerning the move-ins nor reported the move-ins to the Property Supervisor. Thus, DRG did not become aware of the on-site Manager's practices regarding move-ins for two months. Unfortunately, this practice is far too common in the "rental world". Once DRG became apprised of the situation, they responded.

**CONCLUSION:** DRG was precluded by NCC from resolving the outstanding matter with regard to the move-in list because of the timing. DRG is an equal opportunity employer and has consistently subscribed to all aspects of Fair Housing.

**RECOMMENDATIONS:**

- 3.A. DRG has no objection to the IG's recommendation.
- 3.B. DRG has no objection to the IG's recommendation.
- 3.C. DRG has no objection to the IG's recommendation.
- 3.D. DRG has no objection to the IG's recommendation.
- 3.E. DRG has no objection to the IG's recommendation.

**SUMMARY:**

In January of 2000, DRG placed Dale Randle as its Controller, not only to ensure that the Accounting Department of DRG remains fluent, but also to assist with potentially volatile situations which may occur in new or less sophisticated start-up entities requiring management. DRG believes that this was a major step to ensure that it maintains and provides an affluent accounting to its clients. Mr. Randle brings more than 17 years of experience to DRG.





May 30, 2000

Mr. Ronald F. Huritz  
Assistant District Inspector General for Audit  
U.S. Department of Housing & Urban Development  
Office of Inspector General for Audit, Midwest  
77 West Jackson Blvd. Suite 2646  
Chicago, IL 60604-3507

RE: Your May 4, 2000 Audit Findings Letter with Attachments to Shirley Hardiman, President,  
Neighborhood Commons Cooperative

Dear Mr. Huritz:

ATTACHMENT TO MAY 30, 2000 LETTER TO RONALD HURITZ FROM NCC  
Re: Response to Audit Findings – Neighborhood Commons Cooperative

As indicated in the Board of Directors' May 30<sup>th</sup> "Response to Audit Findings", this attachment is hereby submitted. The following overall comments are also offered.

1. Three Board members from the former Board (Erma Woodley, Deborah Joyner, Jean Mays (also current) who were in office and responsible for the decisions made by the Board of Directors entity *were not interviewed or questioned* in reference to the Audit Findings as were all other former Board members.
2. Warren Jones *was not interviewed, questioned, nor given an opportunity to respond* in reference to the Audit Findings.
3. The draft Findings misrepresent the relationship between Warren Jones and Jessie Avraham. Warren Jones is not the "ex-husband" of Jessie Avraham and *should not be represented as such.*

**Finding 1 - Excessive Tenant Accounts Receivable Balance**

IG Recommendation: (See Board of Directors response dated May 30<sup>th</sup>)

The following comments of this writer are made to clarify, correct, and otherwise offer information that will make the official final report more accurate and *free of bias*.

Comment 3 - "Management Agent Failed to Collect Monthly Rent Payments"

The statements made in this section are clear as to the reasons the management agent failed to collect correct monthly rent payments, including the statement from the owner of Diversified Realty Group regarding difficulties. However, even with this clear-cut evidence which can be verified, the IG comments "due to the Board's substantial influence over management discussed in Finding 2, we

question whether it exacerbated the problems...” casts responsibility and blame on the Board of Directors.

Finding 2 neither proves nor substantiates that the Board had substantial influence over the day to day operations of Diversified Realty Group, its policies, procedures, or its main office operations, including accounting and record keeping. The Board had nothing to do with the fact that DRG did not change the rent structure and did not implement the correct rent structure from the beginning of its tenure. The Board had nothing to do with the fact that CHAC paid excessive subsidies.

This writer makes note that the IG must be very careful that it distinguishes the time frame in which activities took place. The problems outlined in the audit began under a different Cooperative President. It should also be noted that during the period of time mentioned that Ms. Avraham was not even a member of the Board of Directors. Certain mismanagement by Diversified Realty Group occurred under a different regime.

It is a spurious accusation and overly exaggerated that both Boards of NCC or its Presidents (former and past) could possibly be responsible for the Standard Operating Procedures of DRG and the main office of that company, since all accounting and accounts receivable matters are inevitably and rightly the responsibility of the Management Agent.

This writer questions the IG interpretation and submits that the Board of Directors in no way coerced or influenced the routine and standardized management protocol of Diversified Realty Group.

#### Comment 4 - “HUD-Approved Rent Schedule Not Uniformly Applied”

Again, the IG appears to making every effort to include the Board as a reason for Diversified’s ineptness. To say that “The Cooperative did not uniformly apply the HUD-approved rent schedule” is, to say the least, evading the reality. The Management Agent had full control of administering the rent schedule. As a matter of fact and record which the IG has apparently overlooked, the two Managers responsible, along with the Management Agent, for applying the incorrect rents were hand-picked by Diversified. One of those managers was responsible for applying the incorrect rents from the beginning that led to the problems that plague the property to this day.

Also, the IG failed to indicate that these issues began during Diversified’s initial tenure under a previous Cooperative President, not Ms. Avraham. The implications of the IG’s statements are far-reaching and potentially libelous.

Again, to make an official statement based on what “Diversified’s owner told us...” could be considered irresponsible in an official report that is supposed to be factual and not supplanted with comments from the entity that caused the problem and who is looking for someone else to blame.

### **Finding 2 - The Board of Directors Abused Its Authority**

IG Recommendations: (See Board of Directors response dated May 30<sup>th</sup>)

- 2.A. This writer disagrees with this recommendation and suggests that “to debar the Board President from all Federal programs” is excessive.
- 2.B. This writer disagrees with this recommendation and based on my knowledge of the situation suggests that “to debar the ex-manager from all Federal programs” is excessive.

This writer suggests that this action is not necessary because the previous President is no longer President, the ex-manager is no longer manager, and a new management agent is in place. Further, no Federal laws relating to the operation of the property were violated. If this suggestion is not acceptable, it is hopeful that an alternative action can be mutually agreed upon at the exit interview.

Since this writer is not an attorney, it is not possible to address the misleading and inaccurate statements throughout Finding 2. At the least, this writer was stunned that an official IG report would contain so much bias and an obvious attempt to defame and discredit. Finding 2 is entitled “The Board of Directors Abused Its Authority”. However, the entire body of the report is profuse with personal and defamatory statements directed at this writer. Because of the implications of the recommendation, it is believed that it will be in the best interest of all involved if I accede to legal advice and confront my accusers at the proper forum. This, I hope, will be the exit interview. I am hopeful that all significant persons, including Deborah Hunter, President of DRG, will be invited to the exit interview. This will allow all parties to voice their opinions and comments before the IG concludes its final recommendations.

As I mentioned to Mr. Mike Chacono during the brief interview he had with me on November 9 of 1999, his questions were not conducive to the audit report or the initial findings. While I was determined to focus on the issues of the initial findings as outlined by Edward Hinsberger’s office and the Board’s response to those findings, Mr. Chacono insisted on asking personal and inappropriate questions. My belief at that time was that I was being personally attacked and defamed and I relayed my impressions to him at that time. My concerns have now proven to be well-founded.

I did not then, and do not now believe that my personal affairs violated anything that has to do with the Operations, Management or Ownership of NCC. Neither the Cooperative nor the members were affected by my personal affairs.

### **Finding 3 - The Cooperative Failed to Provide Equal Opportunity in Housing**

IG Recommendations: (See Board of Directors response dated May 30<sup>th</sup>)

The following comments of this writer are made to clarify, correct, and otherwise offer information in an effort to make the official final report more accurate and *free of bias*.

The summary statement “Additionally, Section 8 vouchers intended for members already residing at the Cooperative instead were improperly awarded to family members of Cooperative tenants...” should be examined.

The record and evidence will show that all current members already residing at the Cooperative had the opportunity to be certified to receive vouchers. Because there were vouchers allocated to NCC that had not been used even after all current, eligible households had been served, CHAC allowed the distribution of the remaining vouchers to adult members of households that had already received vouchers. No rental assistance was “denied” existing members who were eligible to receive it. There was no misappropriation of CHAC vouchers either by Management or the Board of Directors. This statement is fact and is a matter of record.

Thank you for the opportunity to respond to the draft audit findings.

Respectfully Submitted,

Jessie B. Avraham  
Board Member and Previous President  
Neighborhood Commons Cooperative

cc: Board of Directors

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